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SUBJECT: Austrian Airlines Financial Situation Grim;
EU May Pose Hurdles to Lufthansa Merger

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¶1. (SBU) SUMMARY. Austrian Airlines (AUA) is in increasingly dire financial straits despite bridge loans from the GoA. On February 19, new management announced a 2008 operating loss of EUR 100-125 million which would wipe out half of AUA's remaining capital base. Including financial items (write-offs, hedging losses, etc.) AUA's 2008 loss could total EUR 500 million. The management is confident that a bridge loan in December (EUR 200 million) and planned short-term savings (EUR 225 million) will keep AUA in the air until the Lufthansa sale closes in June.

¶2. (SBU) Lufthansa's takeover of AUA is not a done deal. The EU Commission has signaled it will critically review several aspects of the takeover including the GoA subsidy, the modest sales price, and the tender process. If the EU Commission rejects key aspects of the deal -- giving Lufthansa the right to pull out -- AUA would be forced to down-size radically into a regional carrier and could go bankrupt. END SUMMARY.

¶3. (SBU) AUA is in a critical financial situation despite a EUR 500 million GoA subsidy (as part of the merger) and a EUR 200 million bridge loan from state holding company OIAG. On February 19, new AUA co-managers Andreas Bierwirth and Peter Malanik (NOTE: CEO Alfred Oetsch was forced out in late January) announced that operating losses for the past thirteen months were in the range EUR 100-125 million -- half the company's issued share capital of EUR 264 million, requiring public notification under the Austrian Stock Corporation Act. Including write-offs, exchange rate losses, and other financial items, total losses for 2008 will be in the range EUR 400-500 million. Cash-on-hand is reportedly is down to about EUR 130 million. Management expressed confidence that the carrier can survive until the Lufthansa buy-out this summer based on the EUR 200 million OIAG bridge loan and planned short-term savings of EUR 225 million.

¶4. (U) AUA has not weathered the economic crisis well: 2008 saw a 1.1% decline in passenger numbers (Lufthansa: up 1.2%) and a passenger load factor of 75.2% (Lufthansa: 78.6%). In January 2009, AUA's passenger numbers were down 13% year-on-year and passenger load fell to 65.4%.

¶5. (SBU) Bierwirth and Malanik presented austerity measures of EUR 425 million and launched labor negotiations (to be concluded by the end of

February). The EUR 225 million short-term package consists of measures including another 5% capacity reduction in 2009 (on top of an earlier 5% cut, i.e. 10% total) with closure of routes to Ankara, Baia Mare, Burgas, Mumbai, Nuremberg, and Nizhny Novgorod, and reduced frequency on various other routes, particularly domestic flights. Other measures include more flexible working hours, drawing down accrued leave and compensatory time, a temporary salary waiver, and suspending pension fund contributions for a limited period. For the medium-term (through 2012), AUA is targeting additional cost savings of EUR 200 million. NOTE: an AUA representative told us OMV charges more for jet fuel in Vienna than it charges Lufthansa in Munich: AUA expects that the Lufthansa merger will give AUA more clout to drive a harder bargain with OMV in Vienna. END NOTE.

Problems with Lufthansa Merger

¶6. The Lufthansa takeover is not written in stone. Lufthansa has said it will back out if AUA's economic situation at closing (expected in June/July) is much worse than when the deal was signed in December. Lufthansa also has the right to back out if the EU Commission does not approve the deal by the end of June. Assuming the takeover happens, Lufthansa will reportedly have to invest upwards of EUR 1 billion to restructure AUA and reduce its debt (currently EUR 2 billion). AUA's

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net gearing (debt load/equity) for the first nine months of 2008 was 135.4% versus 28.5% for Lufthansa.

¶7. (U) On January 19, the EU Commission authorized the GoA's mid-December guarantee of the OIAG EUR 200 million bridge financing loan for AUA (which must be repaid upon the closing of the AUA/Lufthansa deal). In contrast, on February 11, the Commission opened formal investigations on the sale of AUA to Lufthansa and reportedly will scrutinize in detail:

- the deal's symbolic price: Lufthansa will pay the GoA one euro-cent for each OIAG share -- totaling only EUR 366,268.75 for the 41.56% GoA stake (NOTE: Lufthansa will pay smaller shareholders a fair-market price base on AUA's share price last year)
- the debtor warrant the GoA will receive, which may lead to an additional payment, and
- the GoA's EUR 500 million subsidy to AUA/Lufthansa as part of the sale.

¶8. (U) The Commission indicated it will review whether the sale was truly open, transparent, and final -- pointing to several potential inconsistencies with common market regulations:

- the EUR 500 million subsidy may be excessive
- AUA's restructuring plan may not restore long-term viability, necessitating future subsidies
- the sale price (including the debtor warrant) may not reflect a fair market value for AUA.

¶9. (SBU) COMMENT: If the European Commission rejects the takeover or the deal falls apart for other reasons, AUA could quickly go bankrupt and its only chance for survival would seem to be as a radical down-sized regional carrier.

How will the takeover affect AUA's fleet?

¶10. (U) AUA operates a longhaul Boeing fleet (four

new Boeing 777 and six older 767, along with two 737) and uses Airbus only for short-haul flights. AUA also operates Fokker, Bombardier, und Canadair Jet aircraft on smaller routes. It plans to sell six planes (unspecified) in the medium term in the course of its capacity reduction/cost-cutting program.

11. (SBU) Contacts point out that while Lufthansa has a mixed Boeing-Airbus fleet, it does not operate the Boeing 777 which might raise future questions over their long-term role at AUA (but the carrier sees no reason for change at present). Lufthansa also bought the A-380 as its new-generation long-haul aircraft. At some point in the future, AUA will have to consider which aircraft would replace its ageing 767 fleet. AUA sees bargaining advantages as a Lufthansa partner since it can piggyback on larger purchases with lower unit costs.

KILNER